INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

January 22, 2002

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CASE MIS No.: TAM-139876-01/CC:CORP:B3

Case Manager:

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer =

Trust 1 =

Trust 2 =

Trust 3 =

Family =

Beneficiary M =

Beneficiary N =

Subsidiary =

Advisor =

Asset 1 =

Asset 2 =

Asset 3 =

Asset 4	=
Asset 5	=
Joint Partnership	=
Limited Partnership 1	=
Limited Partnership 2	=
$m	=
$n	=
$o	=
$p	=
$s	=
$t	=
$u	=
x percent	=
y percent	=
z percent	=
Date A	=

ISSUE:

What is the proper method of determining the amount of gain to be recognized upon the distribution of property, pursuant to § 311(b) of the Internal Revenue Code, by Subsidiary to its shareholders upon the formation of Joint Partnership?

CONCLUSION:

Subsidiary's gain should be computed based on the full fair market value of the property distributed without the application of any minority interest discount.

FACTS:

Taxpayer is the parent corporation of a multi-state group of affiliated entities involved in several lines of business. Three trusts, Trust 1, Trust 2, and Trust 3, established for the benefit of members of Family, own almost entirely the outstanding stock of Taxpayer. The beneficiaries of Trust 1 are Beneficiary M and her descendants, the beneficiaries of Trust 2 are Beneficiary N and her descendants, and the beneficiaries of Trust 3 are Beneficiary M, Beneficiary N, and their respective descendants.

Subsidiary is an indirect, wholly owned subsidiary of Taxpayer. Subsidiary owned certain assets that, based on Advisor's advice, members of Family, through Taxpayer, initially decided to sell. After the sale of Asset 1, the Family's continuing reservations about such sales led members of Family to determine that selling certain remaining assets was not in the best interest of Taxpayer. Therefore, members of Family decided to form Joint Partnership into which certain assets of Subsidiary would be contributed. Thus, Subsidiary, Limited Partnership 1 (Beneficiary M's family partnership), and Limited Partnership 2 (Beneficiary N's family partnership) entered into an agreement on Date A, pursuant to which Subsidiary would hold a majority interest in and be managing general partner of Joint Partnership and Limited Partnership 1 and Limited Partnership 2 would hold minority interests and would have very limited rights with respect to the management of Joint Partnership. Subsidiary contributed all of its assets, except for certain working capital, Asset 3, Asset 4, and Asset 5, for its interest in Joint Partnership, and Limited Partnership 1 and Limited Partnership 2 each contributed cash for their respective interests in Joint Partnership.

The fair market value of all the assets, including its primary asset, Asset 2, contributed to Joint Partnership by Subsidiary was $m. Subsidiary has a $p tax bases in those assets. The fair market value of all of the contributed assets and cash was $n, which includes the $o in cash contributed by Limited Partnership 1 and Limited Partnership 2. Subsidiary received an x percent interest in the total assets of Joint Partnership and the Limited Partnerships collectively received a z percent interest in the total assets of Joint Partnership (each receiving a y percent interest), which total to 100 percent.

The examining agent has determined that the value of the percentage interests in Joint Partnership's assets received by Limited Partnership 1 and Limited Partnership 2 exceeds the cash contributed. Likewise, the agent has determined that the value of the assets contributed by Subsidiary exceeds its percentage interest in the partnership's assets received in exchange. The agent concludes that, under § 311(b), there is a deemed distribution of appreciated property by Subsidiary, through intermediate entities, to the shareholders of Taxpayer (ultimately the members of Family), who then contributed the distributed property to Joint Partnership through the limited family partnerships.

In valuing the limited partnership interests received by the limited family partnerships, the agent has applied appropriate discounts. However, the agent asserts that, in valuing the distributed property for purposes of § 311(b), discounts for minority interest and lack of marketability are not applicable. It is the position of Taxpayer that, if there is a § 311(b) distribution, it should be characterized as a distribution of either a minority partnership interest in Joint Partnership or a minority partial interest in Asset 2, with independent valuation of this specific property, taking into account its characteristics and appropriately discounting for minority interest and lack of marketability, and not by reference to the value of the remaining interest retained in Asset 2 by Subsidiary prior to contribution to Joint Partnership.

LAW AND ANALYSIS:

Section 311(b)(1) of the Code provides that if a corporation distributes appreciated (in the hands of the distributing corporation) property to a shareholder, the corporation must recognize gain as if the property had been sold to the distributee shareholder at its fair market value.

Assuming that a § 311(b) distribution has occurred, we agree with the examining agent that, at the corporate level, no discounting for minority interest or lack of marketability should apply. Taxpayer's shareholders also will be subject to the tax consequences of receiving a dividend upon receipt of the appreciated property.

The answer to the question presented is controlled by the analysis in Pope & Talbot, Inc. v. Commissioner, 162 F.3d 1236 (9th Cir. 1999). Pope & Talbot involved an analogous situation. A corporation contributed property to a limited partnership controlled through a series of conduit entities by the corporation's shareholders. The partnership then distributed partnership interests to the corporation's shareholders. A dispute arose between the taxpayer and the Service over the proper method to calculate the fair market value of these interests. The taxpayer believed the value of the interests should be the aggregate of all the individual partnership units, while the Service contended that fair market value should be calculated as if the entire property had been sold by the corporation on the date of the distribution, with no reference to the interest received by each shareholder. Id. at 1238.

The Tax Court approached the issue as being one of what property is to be valued: the entire property interest taken out of corporate solution or the fractional interests received by the shareholders. The court, after analyzing the legislative history of the precursor to § 311(b) and related case law, held that the proper perspective is from that of the corporation and the property should be valued as if the distributing corporation had sold the entire interest in the property on the date of the distribution. Pope & Talbot, Inc. & Subsidiaries v. Commissioner, 104 T.C. 574 (1995).

The Court of Appeals affirmed the Tax Court's decision, holding that the Congressional intent behind this provision focused "entirely on the value of the distributed property in the hands of the corporation, not on its value once the distribution to the shareholders is completed." Pope & Talbot, 162 F.3d at 1239. Section 311(b) and its predecessors were designed to codify repeal of the General Utilities (296 U.S. 200 (1935)) doctrine and prevent corporations from avoiding taxable gain when they distribute appreciated property to shareholders. Id.

Taxpayer tries to distinguish Pope & Talbot by focusing on the fact that, in that case, the corporation distributed 100 percent of its interest in the property to its shareholders in a § 311(b) distribution, whereas, in this case, only an indivisible minority interest in the assets (primarily Asset 2) was distributed. However, Taxpayer itself points out that the legislative history of § 311(d) (the predecessor section to § 311(b) cited in Pope & Talbot) reveals that one of the purposes of the provision was to tax the appreciation in value that has accrued while the distributing corporation held the property and to prevent the corporation from avoiding tax on the inherent gain by distributing that property to its shareholders. Therefore, even though only an indivisible minority interest in the assets has been distributed in this case, rather than the full interest as in Pope & Talbot, it is the full appreciation in value attributable to that distributed percentage interest that must be taxed; otherwise, applying discounting for minority interests or lack of marketability would inappropriately allow a corporation to avoid tax on the inherent gain that would have been recognized on the entire property but for the distribution of an amount less than the whole.

Taxpayer cites numerous cases where illiquidity, lack of control, and lack of marketability discounts have been applied in valuing minority interests. See Estate of Barudin v. Commissioner, 72 T.C.M. (CCH) 488 (1996); Knott v. Commissioner, 54 T.C.M. (CCH) 1249 (1987); Estate of Sels v. Commissioner, 52 T.C.M. (CCH) 731 (1986). However, all of those cited cases are within the estate or gift tax context where minority interests in partnerships or property have passed to individuals by devise or gift. Those principles have no application where the concern is the gain to be recognized by a corporation when it distributes appreciated property to its shareholders. Again, as the Court of Appeals held in Pope & Talbot, the determination of the value of the distributed property in the hands of the distributing corporation does not implicate minority interest discounts (which might nevertheless be appropriately applied in valuing what was received). Additionally, even in the estate and gift tax area, the law is clear that when a gift is valued, its value is measured by reference to the gift in the hands of the donor, not the donee. See Robinette v. Helvering, 318 U.S. 184 (1943); J.C. Shepherd v. Commissioner, 115 T.C. 376, 385 (2000) (holding that in transfer of property, enhancement of recipient's partnership interests immaterial; gift tax imposed on value of what donor transfers, not what donee receives).

Taxpayer further asserts that the legislative history behind § 311(b) suggests that the Congressional intent behind the statute was to ensure that the Code treats a sale of appreciated property by the corporation followed by a distribution of the proceeds to shareholders the same as a distribution of the appreciated property to shareholders followed by a sale of the property by the shareholders.

While this may be one of the purposes behind the statute, the statute is also applicable in addressing the main concerns in the matter before us, which are the taxation of a transfer of value and the avoidance of double discounting. The totality of the facts and circumstances of this case must be taken into consideration and analyzed in determining the value of what the corporation is deemed to have distributed to its shareholders (as opposed to what the shareholders ultimately received).

The fair market value of all of the assets, including Subsidiary's primary Asset 2, contributed to Joint Partnership by Subsidiary was $m. Subsidiary has a $p tax bases in those assets transferred to Joint Partnership. Subsidiary received an x percent interest in the total assets of Joint Partnership, which is worth $s. The limited family partnerships contributed a total of $o in cash to Joint Partnership and jointly received a z percent interest in the total assets of Joint Partnership, which is worth $t. However, Subsidiary's contribution of assets exceeded the value of its percentage share of the total assets received in Joint Partnership by $u. This is the same amount by which the value of the limited family partnerships' total percentage share received exceeded the total amount of cash contributed. This amount, $u, represents the amount of the deemed distribution under § 311(b) made by Subsidiary to its shareholders, ultimately the Family members, who are deemed to have supplemented their cash contribution to Joint Partnership, through the limited family partnerships, with this distributed amount in exchange for their z percent share of the total assets of Joint Partnership.

This amount need not be discounted for minority interests or lack or marketability because all such appropriate discounts have already been taken into account in valuing the limited partnership interests received by Limited Partnership 1 and Limited Partnership 2. If the corporate distribution amount also were to be discounted, double discounting would be improperly applied to both sides of the transaction. The corporate distribution amount ($u) represents the value deemed transferred by Subsidiary to its shareholders, which they received full benefit from, through the limited partnerships, in making their contributions to Joint Partnership and receiving their collective z percent share in Joint Partnership's assets. Discounting is only appropriate for valuing the limited partnership interests received by the limited family partnerships because they reflect the minority limited interests in Joint Partnership and may face marketability issues. Such discounts have already been applied.

It should be noted that this technical advice is based on the premise that a deemed § 311(b) distribution has occurred and does not address any tax characterizations or consequences that may arise under Subchapter K of the Internal Revenue Code. In addition, we do not address the tax treatment of the dividends received by Taxpayer's shareholders as a result of the distribution.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.